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C O N F I D E N T I A L SECTION 01 OF 02 GUANGZHOU 000619

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SUBJECT: Shenzhen Stock Exchange Official Sees Trouble Ahead for
Pearl River Delta Economy

Ref: Guangzhou 214

Classified By: Consul General Robert Goldberg; reasons 1.4(b) and (d)

¶1. (C) Summary: A Shenzhen Stock Exchange (SSE) official believes that the impact of the global financial crisis is already being felt in south China's real economy. However, she acknowledged that many firms are well positioned to weather the storm. She complained about the effect of retail investors on the Shenzhen exchange, which has declined by two-thirds since January. She also lamented that government regulators are holding back SSE's efforts to make it easier for small and medium enterprises (SMEs) to raise capital -- again postponing, this time indefinitely, the launch of a new NASDAQ-like board and preventing qualified companies from listing. The official sees an uncertain role for the SSE in China's financial future and is critical of the ability of Guangdong's local officials to take the lead in the next stage of China's economic development. End Summary.

Concern about Impact on Exports

¶2. (C) SSE Vice Director of Strategy and International Relations Jane Wu believes the U.S. financial crisis is already having an impact on the real economy in Guangdong, pointing to the recent closure of a major toy manufacturer, and was eager to discuss the U.S. reaction to the crisis. Although she acknowledged that China's financial institutions were largely insulated from turbulence overseas, she believes that Guangdong's labor-intensive manufacturers are suffering and headed for even more difficult times due to the effect on demand for China's exports. Wu asserted that China's economy is still too dependent on exports, and she doubts that domestic consumption will be able to drive sufficient levels of growth.

¶3. (SBU) However, Wu noted that many firms in Guangdong were well positioned to weather the storm. When asked about the small and medium enterprises that were already listed on the SSE board, Wu commented that they were generally among the most competitive with track records of success. They have succeeded in raising capital by listing and generally have little difficulty in getting credit from banks.

Lack of Confidence, Psychological Factors

¶4. (SBU) The presence of too many retail investors who lack confidence, react psychologically to market information and move in the same direction is keeping down values on the SSE, according to Wu. She told us that after nearly a year of massive declines -- down two-thirds since January -- value is emerging in some stocks on the Shenzhen exchange. However, due to the lack confidence she could not say when the market might begin to show recovery. She lamented that selling short or other mechanisms that might limit fluctuations in the market were still in trial stages and not being used effectively.

SSE Eager to Help but Being Held Back

15. (C) The SSE is eager to help small and medium enterprises that continue to find it difficult to raise capital in the current environment, but Wu complained that Chinese regulators are holding it back. SSE has long had plans to open a new small and medium enterprise board focusing on firms with potential for innovation. This board, modeled after the NASDAQ, received preliminary approval and had been scheduled to open in May. That was later pushed back to "around the time of the Olympics" (reftel). Wu now tells us that opening the new board has been postponed indefinitely. The situation, she said, is just too volatile.

16. (C) Wu also complained that many qualified firms have applied to list on the SSE, but have not received final approval from central government authorities. She said that approximately 200 firms had met all the requirements and were waiting for the final authorization to list. The government is too cautious, she commented, and worried about an oversupply of stocks on the board. While the United States suffers from a lack of adequate regulation, China still had too much, according to Wu.

No Room for SSE

17. (C) Wu is not certain what purpose the SSE can serve in China's economic future. The Shanghai exchange has all the big companies. Hong Kong has the freedom to offer innovative new financial products. Tianjin is benefiting as the testing ground for many new financial reforms, she said. "There's nothing left for Shenzhen," Wu lamented.

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Gloomy on Guangdong's Prospects Too

18. (C) Wu was similarly pessimistic about Guangdong's future role as a leader in economic reform and innovation in China. She commented that local leaders, even those in the more developed municipalities of Guangzhou and Shenzhen, were not professional and lacked foresight. A Zhejiang native, Wu said that she was more impressed by the local leadership on trips to her home province. Although her comments were more personal than professional, it is interesting that someone like Wu, who came to work for the SSE shortly after its inception in the early 1990s, believes that Guangdong local officials need to move away from their hands-off approach to economic development. She noted that this approach has succeeded in the past, but suggested that a more activist approach is needed now with more investment in human capital, especially in education and the social safety net.

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